"COMPULSORY" MERGERS UNDER SECTION 77 OF THE BANKRUPTCY ACT*

SECTION 77 of the Bankruptcy Act [1] gives the Interstate Commerce Commission primary control over formulating a plan for the reorganization of an insolvent railroad.[2] The debtor railroad is required to submit one plan to the ICC, and other parties in interest are also entitled to submit plans.[3] The ICC may approve any plan submitted, or a plan different from those submitted, or may refuse to approve any plan.[4] No reorganization plan may be consummated without ICC approval.[5] A plan approved by the ICC is certified to a district court.[6] If the court finds that the plan is "fair and equitable"[7] to each class of equitable owners of the railroad, the plan is submitted to them for their affirmation.[8] The court must confirm any plan approved by more than two-thirds of

*St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298 (1954).

1. 47 STAT. 1474 (1933), as amended, 49 STAT. 911 (1935), 11 U.S.C. § 205 (1952).

The nature and development of railroad reorganization under the Bankruptcy Act is discussed in Craven & Fuller, *The 1935 Amendments to the Railroad Bankruptcy Law*, 49 HARV. L. REV. 1254 (1936); Fuller, *The Backgrounds and Techniques of Equity and Bankruptcy Railroad Reorganizations—A Survey*, 7 LAW & CONTEMP. PROB. 377 (1940); Lowenthal, *The Railroad Reorganization Act*, 47 HARV. L. REV. 18 (1933); Swain, *A Decade of Railroad Reorganization Under Section 77 of the Federal Bankruptcy Act*, 56 HARV. L. REV. 1037, 1193 (1943).

2. See, *e.g.*, Group of Institutional Investors v. Chicago, M., St. P. & P.R.R., 318 U.S. 523, 544 (1943); Ecker v. Western P.R.R., 318 U.S. 448, 476 (1943); Smith v. Hoboken R.R.W. & S.S.C. Co., 328 U.S. 123, 130 (1946).

3. 47 STAT. 1477 (1933), as amended, 49 STAT. 917 (1935), 11 U.S.C. § 205(d) (1952).

4. *Ibid.*

5. *Ibid.*

6. *Ibid.*

7. "... [T]he judge shall approve the plan if satisfied that ... [it] is fair and equitable, affords due recognition to the rights of each class ... [and] does not discriminate unfairly in favor of any class ...." 47 STAT. 1478 (1933), as amended, 49 STAT. 1969 (1935), 11 U.S.C. § 205(e) (1952).

"Fair and equitable" has become a term of art. For a plan to be "fair and equitable" it must conform with the rule of "absolute priority" established in the leading case of Northern P. Ry. v. Boyd, 228 U.S. 482 (1913). Under *Boyd*, senior interests must be fully compensated for the "entire bundle of rights" they must surrender before junior interests can participate at all. Consolidated Rock Products Co. v. Du Bois, 312 U.S. 510, 528 (1941); Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 115 (1939). For analyses of capitalization and allocation under *Boyd* see Comment, *Allocation of Securities in Corporate Reorganization: Claims Measurement Through Value Analysis*, 61 YALE L.J. 656 (1952); Comment, *The Full Compensation Doctrine in Corporate Reorganizations: A Schizophrenic Standard*, 63 YALE L.J. 812 (1954).

8. 47 STAT. 1478 (1933), as amended, 49 STAT. 1969 (1935), 11 U.S.C. § 205(e) (1952). However, the court is not required to submit a plan to any class of equitable owners if: (1) their equity is without value; (2) their interests will not be materially and adversely affected by the plan; or (3) the plan provides for cash payments to them of an amount at least equal to the value of their equity. *Ibid.*

The "equitable" owners are those creditors and stockholders whose claims against or

each class,[9] and can use its "cram-down" power to confirm a plan rejected by any class if it finds the rejection is not reasonably justified.[10]

One means of accomplishing reorganization under the Bankruptcy Act is by merger.[11] However, the Act contains a "consistency clause" which permits the ICC to grant the authority needed to execute a merger only if the grant is "not inconsistent with the provisions and purposes" of the Interstate Commerce Act.[12]

Section 5 of the Commerce Act, which governs mergers of solvent railroads, gives the merging carriers primary control over the formulation of a merger plan.[13] Under this Act the ICC has no power to propose or modify merger plans:[14] it can only veto plans voluntarily proposed to it by the merging carriers if those plans fail to comply with the statute's substantive standards of public interest.[15]

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interest in the railroad have been allowed by the ICC. See 47 STAT. 1476 (1933), as amended, 49 STAT. 914 (1935), 11 U.S.C. § 205(c)(7)-(11) (1952). They are the parties who will have claims against and/or interests in the reorganized road and are therefore entitled to participate in the voting on reorganization plans.

9. 47 STAT. 1478 (1933), as amended, 49 STAT. 1969 (1935), 11 U.S.C. § 205(e) (1952).

10. The judge has discretionary power to confirm a rejected plan if it "makes adequate provision for fair and equitable treatment . . . for those rejecting it," and if their rejection is not "reasonably justified." *Ibid.* The courts have given liberal construction to this power. See, *e.g.*, RFC v. Denver & R.G.W.R.R., 328 U.S. 495, 535 (1946); *In re* Chicago, R.I. & P.R.R., 160 F.2d 942, 945 (7th Cir.), *cert. denied*, 332 U.S. 793 (1947); *In re* Chicago & N.W.R.R., 126 F.2d 351, 365 (7th Cir. 1942), *cert. denied*, 318 U.S. 792 (1943). In *Denver & R.G.W.*, 80% of the general bondholders, a class whose claims totalled 25% of all classes' claims against the road, rejected the plan. *Id.* at 503, 537. The rejection was not permitted.

11. A reorganization plan "shall provide adequate means for the execution of the plan, which may include . . . the merger or consolidation of the debtor with another corporation . . . the sale of all or any part of the property of the debtor . . . [and] any other appropriate provisions not inconsistent with this section." 47 STAT. 1474 (1933), as amended, 49 STAT. 913 (1935), 11 U.S.C. § 205(b)(5) (1952).

12. Once a plan is confirmed, the ICC is empowered to "grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger . . . to the extent contemplated by the plan and not inconsistent with the provisions and purposes" of the Interstate Commerce Act. 47 STAT. 1478 (1933), as amended, 49 STAT. 920 (1935), 11 U.S.C. § 205(f) (1952). This subsection was named the "consistency clause" by counsel for appellants, Brief for Appellees, p. 64, St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298 (1954), and this name was adopted by the Supreme Court. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298 (1954) *passim*. It has no legislative or historic significance.

13. 24 STAT. 379 (1887), as amended, 54 STAT. 905 (1940), 49 U.S.C. § 5 (1952) (Transportation Act of 1940).

14. *Ibid.* While the Act does not explicitly deny the ICC the power to initiate merger plans, the power is not expressly given and has never been exercised. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 315 *et seq.* (1954); LEONARD, RAILROAD CONSOLIDATION UNDER THE TRANSPORTATION ACT OF 1920, c. 3 (1946).

15. If the ICC finds that, subject to such terms as it finds to be just and reasonable, the merger plan proposed to it by the railroads is consistent with the public interest, it is au-

In the recent case of *St. Joe Paper Co. v. Atlantic Coast Line R.R.*,[16] the Supreme Court held that the consistency clause of the Bankruptcy Act required mergers under that Act to satisfy the initiation procedure of the Commerce Act.[17] After years of unsuccessful efforts to reorganize the insolvent Florida East Coast Railway,[18] Atlantic Coast Line, a connecting carrier, proposed a merger of the two railroads.[19] The ICC modified and approved Atlantic's

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thorized to approve the plan and submit it to a vote of the railroads' stockholders. The Commerce Act specifically enumerates the four substantive standards that the ICC must consider in determining whether a merger plan is consistent with the public interest: (1) the effect of the plan upon adequate public transportation service; (2) the effect of including or failing to include other railroads in the plan; (3) the total fixed charges resulting; and (4) the effect of the merger upon the railroads' employees. 24 STAT. 379 (1887), as amended, 54 STAT. 905 (1940), 49 U.S.C. § 5 (1952).

16. 347 U.S. 298, *rehearing denied*, 347 U.S. 980 (1954). Justice Frankfurter wrote the opinion for the majority. Justice Douglas wrote the dissenting opinion for Justices Burton, Minton and himself. *See* St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 321 (1954). Justices Black and Clark did not participate in the decision.

17. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 306 (1954).

18. The Florida East Coast Railway has 571 miles of line, and total assets of $111,463,946. STANDARD & POOR'S CORP., STANDARD CORPORATE DESCRIPTIONS, 9881-3 (July 1954). It was in equity receivership from 1931 to 1941, and was in reorganization from 1941 to 1954. Many plans of reorganization were submitted and argued by almost all of the interested parties, but no plan was ever confirmed. See the Supreme Court's summary of the case history; St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 300-03 (1954). After *St. Joe*, the District Court, following the Supreme Court's mandate, dismissed proceedings under the Bankruptcy Act and ordered the debtor railroad back into equity receivership. *In the Matter of* Florida East Coast Ry., Civil No. 4827-J, S.D. Fla., June 28, 1954. The District Court stated that there had been unreasonable delay in approving a plan under § 77 and that an internal consent plan could be speedily achieved by means of an equity foreclosure sale. *Id.* at 3.

During the time that Florida was in reorganization the stock was adjudged to be without value, unsecured creditors were to be paid off in cash, and participation in the reorganized railroad was limited to the holders of the 5% refunding bonds—Florida's equitable owners. *In re* Florida East Coast Ry., 81 F. Supp. 926, 932 (S.D. Fla. 1949). St. Joe Paper Co. has a controlling interest in these bonds (56%) which it acquired after reorganization proceedings had begun. *Id.* at 928. St. Joe vigorously desires an internal reorganization, which would give it control over the stock of the new railroad. Florida East Coast Ry. Reorganization, 267 I.C.C. 295, 313 (1947). It has opposed all plans which failed to give it control. See, *e.g.*, *id.* at 299; St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 300, 301 (1954), and cases there cited. However, St. Joe is owned by the Du Pont estate, and the ICC has expressly found that it is detrimental to the interests of the people of Florida to permit the operations of the road to be controlled by the Du Pont banking and commercial interests. Florida East Coast Ry. Reorganization, 282 I.C.C. 81, 187 (1951).

St. Joe's 56% bond interest places it in a position to veto any plan, in bankruptcy or in equity receivership proceedings, under which it would not control the stock in the reorganized railroad. But the ICC is likely to refuse to approve plans under which St. Joe controls the stock on the ground that they are inconsistent with the public interest. Thus the speedy internal reorganization in an equity foreclosure that the District Court envisaged is likely to be illusory.

19. Florida East Coast Ry. Reorganization, 267 I.C.C. 295, 295-8 (1947). Atlantic Coast Line is larger than Florida, with 5300 miles of track and total assets of $509,594,945.

plan [20] even though it appeared to be strongly opposed by Florida's bondholders —its equitable owners.[21] A series of judicial rejections, remands, and appeals followed.[22] The Supreme Court held that since the merger plan had not been voluntarily submitted to the ICC by both merging carriers,[23] it was a "compulsory" merger which the ICC had no power to approve.[24] The Court reasoned that the carriers were the only parties qualified to propose mergers under the

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STANDARD & POOR'S CORP., STANDARD CORPORATE DESCRIPTIONS, 5153, 4167 (July 1954). The two lines jointly own a steamship company and share a common terminal abutment in Jacksonville, Fla. *Id.* at 5155, 9881. The freight interchange between the two equalled Florida's freight interchange with all other roads. Florida East Coast Ry. Reorganization, 267 I.C.C. 295, 312 (1947). But there is no inter-stock or parental relation between them. *Ibid.*

Long after proceedings in reorganization had begun, Atlantic "bought up" $1.9 million of unsecured claims against Florida at a cost of only $5000. *In re* Florida East Coast Ry., 103 F. Supp. 825, 830 (S.D. Fla. 1952). The claims are now valued at over $1 million. *Ibid.* The ICC therefore gave it its consent to file a plan of reorganization as a party in interest. Florida East Coast Ry. Reorganization, 261 I.C.C. 151, 190 (1945); Florida East Coast Ry. Reorganization, 267 I.C.C. 295, 300 (1947).

20. Florida East Coast Ry. Reorganization, 282 I.C.C. 81 (1951). The ICC found that the plan provided for the fair treatment of Florida's bondholders, *id.* at 187; and that it was in the public interest under the four substantive criteria established in the Commerce Act, *id.* at 130, 132, 134, 140, 142. See note 15 *supra*.

21. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 301 (1954); *In re* Florida East Coast Ry., 81 F. Supp. 926, 932 (S.D. Fla. 1949).

Since Atlantic's plan has never been judicially approved the bondholders have not voted upon it. However, 76% of the bond holdings have gone on record at various hearings, Brief for Appellees, p. 43, St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298 (1954), and 99% of these have opposed Atlantic's plan. *In re* Florida East Coast Ry., 103 F. Supp. 825, 833 (S.D. Fla. 1951).

22. The District Court set aside the ICC plan because it was not fair and equitable and because it would force an undesired merger upon the bondholders. *In re* Florida East Coast Ry., 81 F. Supp. 926, 932, 933 (S.D. Fla. 1949). The Fifth Circuit agreed that the plan was not fair and equitable and affirmed. Atlantic Coast Line R.R. v. St. Joe Paper Co., 179 F.2d 539, 543 (5th Cir.), *cert. denied*, 339 U.S. 929 (1950). However, it further held that the inclusion of a "forced" merger in the plan was valid, and therefore remanded to the ICC to formulate a fairer plan which might include a merger. *Id.* at 544. The ICC modified the plan by increasing the capitalization, but retained the merger. Florida East Coast Ry. Reorganization, 282 I.C.C. 81 (1951). The District Court again found that the plan was not fair and equitable, and therefore set the plan aside, dismissed § 77 proceedings, and ordered a foreclosure sale on the bonds, in order to allow the bondholders to agree on their own plan. *In re* Florida East Coast Ry., 103 F. Supp. 825, 834, 847 (S.D. Fla. 1952). The Circuit Court found the ICC's revised plan fair and equitable, and reversed. Atlantic Coast Line R.R. v. St. Joe Paper Co., 201 F.2d 325 (5th Cir. 1953). The Supreme Court, refusing to review the fairness of the plan, granted certiorari on the sole question of the ICC's power to propose a "forced" merger. St. Joe Paper Co. v. Atlantic Coast Line R.R., 345 U.S. 948 (1953).

23. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 309 (1954).

24. *Id.* at 302 n.2, 306. "We therefore conclude that the Commission does not have under § 77 a power which Congress has repeatedly denied to it under the Interstate Commerce Act, namely to initiate the merger or consolidation of two railroads." *Id.* at 306. See 40 A.B.A.J. 617 (1954).

Commerce Act and therefore, by the consistency clause, the only parties qualified to do so under the Bankruptcy Act.[25] Three Justices stated in dissent that the ICC had properly formulated and approved the merger plan. They argued that the consistency clause did not incorporate the initiation procedure of the Commerce Act into the Bankruptcy Act.[26]

The Court assumed that since the ICC had certified the merger plan the debtor carrier would be "compelled" to merge.[27] Use of the cram-down makes it possible to force through a merger plan rejected by the equitable owners of a railroad.[28] However, such force had not been exerted in *St. Joe*, because the merger plan had not yet been submitted to Florida's bondholders.[29] The real

25. *Id.* at 305, 309.

26. *Id.* at 327. The dissent argued that the mere proposal of a plan was not compulsion, and that the Court should reserve its opinion on the validity of a "forced" merger plan until the cram-down powers were used to enforce the merger plan over the objections of the bondholders. *Ibid.* Although almost 76% of the bondholders were on record against the plan, see note 21 *supra*, "election campaigns sometimes change votes." St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 323 (1954). The dissent concluded that to give the stock interests *"a veto power where Congress has provided they shall not vote is to indulge in as bold a piece of judicial legislation as one can find in the books."* *Id.* at 328.

27. *Id.* at 298, 299, 302, 313, 314. The Supreme Court defined a "compulsory" merger plan as one in which the merger plan is "foisted upon one of the parties by the Commission, as distinguished from a merger voluntarily initiated by the participating carriers." *Id.* at 302 n.2.

The Court stated that if the terms of the plan submitted to the security holders were formulated by the ICC rather than by the carriers the security holders would be faced with a "Hobson's choice." *Id.* at 313. They would have to accept the plan as it stood, or reject it in its entirety and face the possibility of years of delay before another plan could be formulated. However, it is clear that Congress, when it passed the Bankruptcy Act, intended to give the ICC the power to formulate the terms of reorganization plans and leave just such a narrow choice to the security holders. See notes 51, 56, and 60 *infra*.

28. 47 STAT. 1478 (1933), as amended, 49 STAT. 1969 (1935), 11 U.S.C. § 205(e) (1952). See note 10 *supra*.

29. *See* St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 323 (1954) (dissenting opinion). If the threat of imposing a plan upon the bondholders was what really worried the Court, its decision should have been postponed until force had actually been exerted. *Id.* at 331. *Cf.* Wright v. Group of Institutional Investors, 160 F.2d 163, 164 (8th Cir. 1947), *cert. denied sub nom.* Comstock v. Group of Institutional Investors, 335 U.S. 837 (1948); Brooks v. St. Louis-S.F. Ry., 153 F.2d 312, 318 (8th Cir. 1946), *cert. denied*, 328 U.S. 867 (1947). But, for an indication that the Supreme Court majority would not allow the cram-down to be used on *any* merger plan under the Bankruptcy Act, see *St. Joe, supra*, at 314 and n.14.

There was nothing in the record before the Supreme Court to indicate whether or not the Florida's stockholders and board of directors favored Atlantic's plan. Therefore, it could not have been their objections to the plan that moved the Court to decide the plan was invalid. In fact, the board of directors approved Atlantic's merger plan as soon as it was asked to do so. See the statement of W. R. Kenan, Jr., President of Florida East Coast and trustee of the estate of the sole stockholder, dated April 13, 1954. Transcript of Record, pp. 55, 66, 68, *In the Matter of* Florida East Coast Ry., Civil No. 4827-J, S.D. Fla., June 21, 1954.

issue was not the compulsion of the plan but the validity of its formulation.[30] This is borne out by the Court's statement that, because the plan had been initiated by the ICC,[31] it was "congenitally" defective even if the equitable owners subsequently approved it.[32]

The Bankruptcy Act does not require that the debtor carrier must propose each merger plan.[33] It specifically enumerates other parties who may also propose plans: the trustees, ten percent of the bond- or stockholders, or an ICC-approved party in interest.[34] It also grants the ICC wide powers of modification and change.[35] Moreover, in *St. Joe* the debtor at its own request had been relieved of its duty to propose a plan.[36] However, the Court concluded that any merger plan not proposed by the debtor was invalid,[37] defining the debtor as "those who in the absence of § 77 would wield the corporate merger powers."[38] This definition presumably meant the board of directors, acting for the former stockholders,[39] and would seem to exclude all other enumerated parties, except perhaps the bondholders.[40] The approval of Florida's board,

30. The Supreme Court itself stated that the cram-down had "no bearing on this case." St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 314 (1954).

31. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 306 (1954). While the merger plan in *St. Joe* was in fact initiated by Atlantic, a party in interest, see note 19 *supra*, the Supreme Court apparently equated the ICC's submission of the plan to the district court with initiation. See, *e.g.*, St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 299 (1954).

32. *Id.* at 313, 314.

33. The debtor carrier is required to propose a plan of reorganization within six months of the commencement of reorganization proceedings. 47 STAT. 1477 (1933), as amended, 49 STAT. 917 (1935), 11 U.S.C. § 205(d) (1952). Thereafter it has no statutory right or duty to propose plans except, presumably, as a party in interest.

34. *Ibid.*

35. *Ibid.*

36. In 1941 Florida East Coast had petitioned the court to be relieved of "any duty under § 77 to file a plan of reorganization." The court's order, of January 31, 1941, granted that petition. See *In the Matter of* Florida East Coast Ry., Civil No. 4827-J, S.D. Fla., June 28, 1954, at p. 7.

37. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 309, 314 (1954).

38. *Id.* at 309 n.12.

39. *Id.* at 309 n.12. *See id.* at 328 (dissenting opinion).

40. Neither the trustees nor 10% of any class of stock- or bondholders nor an ICC-approved party in interest can wield the corporate merger powers if there is no reorganization. Only the stockholders' board of directors can do that. 24 STAT. 379 (1887), as amended, 54 STAT. 905 (1940), 49 U.S.C. § 5 (1952). Therefore, under *St. Joe*, these parties will be unable to propose a merger plan even if there is a reorganization.

There is a slight possibility, however, that the bondholders can still propose a plan. The Court acknowledged that they were "in substance the owners of the debtor railroad." St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 301 (1954). It found the plan invalid because it was proposed by the ICC rather than "their own corporation." *Id.* at 314. This might indicate an intent to give merger control to the bondholders, who are the railroad's future stockholders and will, when the reorganization is complete, wield the merger powers. The phrase "in the absence of § 77" *could* be construed to mean after reorganization was culminated. Clearly, 10% of the bondholders would not be sufficient to propose a plan,

representing stockholders who had no equity in the reorganized railroad, was thereby made a prerequisite to the validity of the merger plan.

Limiting the merger proposal power to the debtor's board of directors gives the stockholders an unwarranted power over reorganization. If the board does not favor merger there can be no merger.[41] The board may be willing to propose a merger only if it is able to exploit its strong bargaining position to secure for the stockholders financial compensation to which their equitable interest in the railroad might not have previously entitled them.[42] But these plans may be so favorable to the stock interests that they fail to satisfy the "fair and equitable" requirement.[43] Thus, mergers might be practically unavailable in bankruptcy proceedings.[44] Dictum indicates that *St. Joe* probably will not apply to mergers

since they could not "wield the corporate merger powers" at any time. But the courts might allow the same percentage of bondholders to propose a merger under the Bankruptcy Act as the Commerce Act requires for stockholders to approve a merger when it is submitted to them: *i.e.*, at least a majority and more if the state merger law so requires. See 24 STAT. 379, (1887), as amended, 54 STAT. 908 (1940), 49 U.S.C. § 5(11) (1952).

41. *See* St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 328 (1954) (dissenting opinion). See also text at notes 23, 39, and 40 *supra.*

42. Immediately after *St. Joe* was decided, a merger plan was filed before the ICC in the intra-family reorganization of the Missouri-Pacific Railroad that gave the stock 5 to 10% of the new class B common stock, whereas for twenty years the Mo-Pac's stock had been considered valueless for reorganization purposes. See Wall Street Journal, May 6, 1954, p. 3, col. 1; May 12, 1954, p. 24, col. 4. See also the statement of Mo-Pac's chairman, that *St. Joe* gave the stock a "whip hand" in the Mo-Pac reorganization. *Id.* April 7, 1954, p. 8, col. 2. See ICC Docket No. 9918 (Nov. 9, 1954).

43. The old management will hardly propose a plan that is not favorable to the stockholders. But if the stock has no value, a plan favorable to it would violate the *Boyd* rule unless all the senior interests have been fully compensated for the "bundle of rights" they have surrendered. See note 7 *supra.* And since a railroad under reorganization is either insolvent or cannot pay its debts as they mature, see note 2 *supra,* it is usually impossible for anything to be left over for the stockholders after the senior interests have been fully compensated.

The Commerce Act does not allow the ICC to modify merger plans submitted to it by the merging carriers and, under *St. Joe's* interpretation of the consistency clause, it is unlikely that the ICC will be able to do so under the Bankruptcy Act. The *fait accompli* will have returned to bankruptcy proceedings, since the ICC will have to choose between approving a merger plan it does not altogether favor or refusing to approve any merger at all. The kind of Hobson's choice, more or less, to which the ICC would thus be put would make it impossible for the ICC to exercise the leadership in formulating reorganization plans that the Bankruptcy Act bestowed upon it. See notes 51 and 60 *infra.*

44. The power *St. Joe* gives the stock interests is equivalent to that which they have over capital readjustment under § 20b of the Commerce Act, 62 STAT. 163, 49 U.S.C. § 20b (1952) (Mahaffie Act). Under the Mahaffie Act "the management of the carrier represents the only source from which the original plan can emanate, . . . a departure from the proceedings under § 77." Comment, *Streamlined Capital Readjustment Under § 20b of the Interstate Commerce Act,* 58 YALE L.J. 1291, 1303 (1949). See Hand & Cummings, *Consensual Securities Modification,* 63 HARV. L. REV. 957, 968 (1950); Wren, *Some Procedural Aspects of 20b Reorganizations,* 60 OKLA. L. REV. 467 (1953). The Mahaffie Act provides for speedier readjustments, but much of the speed is gained by relaxing the safeguards § 77 set up to preserve creditors' interests. Comment, *supra.* In order to scale down creditors' claims without eliminating the stock, the Mahaffie Act had to eliminate the "fair and equitable"

of parent-subsidiary lines.[45] But it is likely to apply to consolidations,[46] sales of assets,[47] and long-term leases,[48] as well as mergers. Thus the decision may cripple large segments of the Bankruptcy Act.

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standard. As a result of *St. Joe*, similar revision of § 77 may be necessary, because the benefits accruing to the stockholders under *St. Joe* will not square with the "fair and equitable" doctrine. See text at notes 42-3 *supra*. But a superior solution would be Congressional revision of § 77, granting the proposal power to each enumerated party in even more unequivocal language than in the present law.

45. The Court distinguished *St. Joe* from previous mergers by noting that every other merger adjudicated under § 77 was either proposed by the debtor or "involved a parent and its subsidiaries, and was treated essentially as an internal reorganization." St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 309 n.12 (1954). This strongly implies that family mergers are distinguishable, but the Court concluded that it was "not now called upon to pass on the validity of the latter type of merger." *Ibid.* During the reorganization of the Missouri Pacific R.R. the ICC submitted a merger plan which was different from that submitted to it by the stock holders of all the roads involved. It distinguished *St. Joe* on the ground that Mo-Pac was an inter-family reorganization, and that *St. Joe* should be strictly limited to its facts. Missouri Pacific R.R. Reorganization, 23 U.S. L. WEEK 2239 (ICC, Nov. 23, 1954). But for an indication that the Supreme Court might not be so willing to restrict *St. Joe* to non-family mergers, *compare* the language that the Supreme Court finally used in distinguishing family mergers, St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 309 n.12 (1954), quoted above, *with* its original, less tentative language, 22 U.S.L. WEEK 4193 n.12 (U.S. April 6, 1954). The question is still open. See note 42 *supra*.

46. The Supreme Court used "merger" and "consolidation" interchangeably. See St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298 (1954) *passim*. Consolidations, as well as sales of assets and long-term leases, see notes 47 and 48 *infra*, although technically different from mergers, are *de facto* unifications; and if *St. Joe* does not extend to such variants, the decision can be easily evaded by means of these simple drafting devices.

47. Mergers and sales of assets are substantially equivalent, especially if the sale is for another railroad's securities rather than cash. See LEONARD, RAILROAD CONSOLIDATION UNDER THE TRANSPORTATION ACT OF 1920, p. 13, 1946; IIIA SHARFMAN, THE INTERSTATE COMMERCE COMMISSION 443 (1931). Atlantic's plan had in fact called for effectuation by means of a merger or a sale. *See* Atlantic Coast Line R.R. v. St. Joe Paper Co., 347 U.S. 980 (1954) (dissenting opinion). However, the petition for certiorari and the original Supreme Court opinion in *St. Joe* were limited to mergers. 345 U.S. 948 (1953); 347 U.S. 298, 299 (1954). The Court, Justice Douglas dissenting, refused to grant rehearing to consider the validity of a plan calling for the sale of all Florida's assets to Atlantic, 347 U.S. 980 (1954) (*per curiam*), which indicates that the Court probably considers a sale as a *de facto* merger. However, the Court is not obliged to review questions not in the writ for certiorari, and the denial of rehearing could have been on that ground. See Connecticut Ry. & Lighting Co. v. Palmer, 305 U.S. 493, 496 (1939); General Talking Pictures v. Western Electric, 304 U.S. 175, 177-9 (1938). Thus the validity of a "forced" sale is still undecided. *See* Atlantic Coast Line R.R. v. St. Joe Paper Co., 347 U.S. 980 (1954) (dissenting opinion).

The consistency clause applies to sales as well as mergers. See 47 STAT. 1478 (1933), as amended, 49 STAT. 920 (1935), 11 U.S.C. § 205(f) (1952). But the initiation procedure for sales under the Commerce Act is different from that for mergers: only the railroad seeking to purchase the assets is required to propose the plan. See, *e.g.*, Erie R.R. Purchase, 254 I.C.C. 486, 490 (1943); Alton R.R. Reorganization, 261 I.C.C. 343 (1945); and cases cited by Mr. Justice Douglas, Atlantic Coast Line R.R. v. St. Joe Paper Co., 347 U.S. 980, 982 (1954) (dissenting opinion). Furthermore, the ICC has long considered sales to be distinguishable from mergers. See IIIA SHARFMAN, *op. cit. supra* at 439 and cases there cited.

48. If *St. Joe* applies to sales it is almost certain to apply to long-term leases. A 999

St. Joe fundamentally changes the theory of the Bankruptcy Act. Before passage of the Act the debtor board dominated reorganization.[49] The Act was passed to cure the evils of this domination,[50] and to place reorganization power in the ICC, representing the public interest;[51] the equitable owners, representing the private interests;[52] and the courts, representing both.[53] The debtor board, having no interest, was divested of all title and control over the railroad,[54]

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year lease of a railroad's entire assets is virtually equivalent to an outright purchase. See Meck & Masten, *Railroad Leases and Reorganization*, 49 YALE L.J. 626, 636 (1940); IIIA SHARFMAN, *op. cit. supra* note 47, at 449 and cases there cited. The Commerce Act treats leases and sales similarly. See 24 STAT. 380 (1887), as amended, 54 STAT. 905 (1940), 49 U.S.C. § 5(2)(a)(1) (1952). The Supreme Court has recognized their virtual equivalence. *See* Palmer v. Connecticut Ry. & Lighting Co., 311 U.S. 544, 555 (1941); Connecticut Ry. & Lighting Co. v. Palmer, 305 U.S. 493, 502 (1939). Although the consistency clause does not apply explicitly to leases, it does mention "assumption of obligations," see 47 STAT. 1478 (1933), as amended, 49 STAT. 920 (1935), 11 U.S.C. § 205(f) (1952); since in practice railroad leases and assumptions of obligations are inevitably connected, it might be argued that the latter phrase incorporates leases into the consistency clause by reference.

49. LOWENTHAL, THE INVESTOR PAYS (1933); Letter to Senator Hastings from Joseph B. Eastman, ICC Commissioner and Chairman of ICC Legislative Policy Committee, dated Jan. 31, 1933, reproduced in *Hearings before the Special House Subcommittee on the Judiciary on S. 1869*, 76th Cong., 1st Sess. 144, at 148 (1939); Investigation of Chicago, M., & St. P. Ry., 131 I.C.C. 615 (1928); IIIA SHARFMAN, *op. cit. supra* note 47, at 578, 579; Fuller, *The Background and Techniques of Equity and Bankruptcy Railroad Reorganizations—A Survey*, 7 LAW & CONTEMP. PROB. 377, 385 (1940).

50. Eastman, Letter, *supra* note 49, at 148; 76 CONG. REC. 2917 (1933); Polatsek, *The Wreck of the Old 77*, 34 CORNELL L.Q. 532, 546 (1948). *See* New England Coal & Coke Co. v. Rutland R.R., 143 F.2d 179, 184 (2d Cir. 1944) (§ 77 was passed to prevent the "notorious evils and abuses of consent receiverships"); *In re* New York, N.H. & H.R.R., 147 F.2d 40 (2d Cir.), *cert. denied*, 325 U.S. 884 (1945).

51. *See* Group of Institutional Investors v. Chicago, M., St. P. & P.R.R., 318 U.S. 523, 536 (1943); Ecker v. Western Pacific R.R., 318 U.S. 448, 468 (1943); Smith v. Hoboken R.R.W. & S.S.C. Co., 328 U.S. 123, 130 (1946). See also *Report of the Federal Coordinator of Transportation*, H.R. Doc. No. 89, 74th Cong., 1st Sess. 37 (1935); remarks of Congressman La Guardia *et al*, *infra* note 60; Fuller, *supra* note 49, at 387.

52. Eastman, Letter, *supra* note 49, at 152. See 47 STAT. 1477 (1933), as amended, 49 STAT. 917 (1935), 11 U.S.C. § 205(d) (1952).

53. *See* Group of Institutional Investors v. Chicago, M., St. P. & P.R.R., 318 U.S. 523, 536 (1943); Ecker v. Western Pacific R.R., 318 U.S. 448, 468 (1943). "The function of the District Court is principally that of moderator or umpire." Chicago, R.I. & P. Ry. v. Fleming, 157 F.2d 241, 244 (7th Cir.), *cert. denied*, 329 U.S. 780 (1946). See text at note 10 *supra*.

54. 47 STAT. 1476 (1933), as amended, 49 STAT. 914 (1935), 11 U.S.C. § 205(c)(2) (1952).

The Supreme Court cites to several sources referring to the "corporate continuity" of the debtor railroad. St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 309 n.12. However, neither the Bankruptcy Act nor the cases give the old management any power after the proposal of a reorganization plan. See 47 STAT. 1474 (1933), as amended, 49 STAT. 911 (1935), 11 U.S.C. § 205 (1952). See also Van Schaick v. McCarthy, 116 F.2d 987 (10th Cir. 1941) (the *trustee* is required to make expenditures to maintain the "corporate continuity" of the railroad); Thompson v. Louisiana, 98 F.2d 108 (8th Cir. 1938) (same).

retaining only the power to propose one plan.[55] To give the board the sole power to propose mergers during reorganization because it had this power before reorganization reveals a "basic misunderstanding" of the Bankruptcy Act.[56]

There is no authority to indicate that the consistency clause incorporated the initiation procedure of the Commerce Act.[57] The Bankruptcy Act deals with insolvent roads in the light of the financial problem, and provides for mergers and for compulsion.[58] The Commerce Act deals with solvent roads in the light

55. 47 STAT. 1477 (1933), as amended, 49 STAT. 917 (1935), 11 U.S.C. § 205(d) (1952). See note 33 *supra*.

56. *See* St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 329 (1954) (dissenting opinion). To give the board of directors sole power to propose mergers during reorganization, when the trustees control the operation of the railroad, see note 54 *supra*, is in fact inconsistent with the purposes of the Commerce Act which gave merger proposal powers to the board because the railroad was solvent and the board was operating it. See Eastman, Letter, *supra* note 49, at 148. *Cf. In re* Chicago, R.I. & P. Ry., 168 F.2d 587, 594 (7th Cir.), *cert. denied sub nom.* Texas v. Brown, 335 U.S. 855 (1948).

57. The legislative history upon which the Court relies does not, in context, sustain its position in *St. Joe*.

At page 304 of its decision the Court cites part of a letter from Commissioner Eastman, *supra* note 49. In context, the letter reveals that Mr. Eastman sponsored the Bankruptcy Act primarily because it took control of the reorganization plan from the old board of directors and gave it to the ICC. *Id.* at 148. See notes 49 and 51 *supra*. He proposed that Congress insert consistency clauses into the Act to insure a consistency with the standards for mergers under the national transportation policy of the Commerce Act, *id.* at 155, and to "safeguard the ultimate authority of the Commission" over mergers, *id.* at 153. There is nothing in his letter to suggest a limitation on who might propose merger plans.

At pages 304 and 305 the Court cites to passages from the Congressional debates which indicate that mergers under § 77 could not be accomplished "in violation of" the Commerce Act and that § 77 gave the ICC no added powers over mergers. But the first statement, by Representative Sumners, was made in reference to a prior statement that railroads might merge under § 77 in violation of the *anti-trust* provisions of the Commerce Act. 76 CONG. REC. 2908 (1933). The second statement, by Representative Rayburn, was directed to a prior statement that railroads might feign insolvency to come under the more liberal provisions of the Bankruptcy Act. *Id.* at 2916. In context neither is relevant to the incorporation of the Commerce Act's initiation procedure into the Bankruptcy Act.

At page 306 the Court cites to a quotation from 52 I.C.C. ANN. REP. 23 (1938) (consolidations cannot be "crammed down the throats of those who must carry them out"), and at page 308 it notes that the ICC bemoaned its inability to initiate mergers. Both of these statements referred only to the merger of solvent roads under the Commerce Act. Like the abundant history of the Commerce Act, which the Court cites in its appendix, p. 315 *et seq.*, this clearly does not prove that reorganization under § 77 was necessarily intended to be a voluntary, consensual act, or that § 77 incorporated the merger procedure of the Commerce Act.

The remainder of the Court's legislative history rests upon subsequent bills attempting to change the present law. None of these bills was ever passed. These bills and the speeches and reports favoring them should not be used as authoritative interpretations of the law they attempted to change. The Supreme Court has stated that it is to interpret § 77 only in the light of the words of the Act and the *contemporaneous* discussion in Congress. RFC v. Denver & R.G.W.R.R., 328 U.S. 495, 510-12 (1946).

58. 47 STAT. 1475, 1478 (1933), as amended, 49 STAT. 913, 1969 (1935), 11 U.S.C. §§ 205(b)(5), (e) (1952).

of the transportation problem, and provides only for voluntary mergers.[59] Since the purposes of the two Acts were different, the procedures established in them were separate and distinct. The consistency clause was meant to require not a procedural but a substantive public-interest consistency for mergers under both Acts:[60] Congress directed that mergers should not be used to solve the financial problems of insolvent railroads without sufficient findings of public interest to justify them if they had been proposed under the Commerce Act.[61] But it established the procedure by which insolvent railroads might merge in the Bankruptcy Act.[62] It is hardly likely that Congress intended the consistency clause to impose limitations which would make this procedure illusory.

59. 24 STAT. 379 (1887), as amended, 54 STAT. 905 (1940), 49 U.S.C. § 5 (1952). See note 14 *supra*.

60. While the ICC must make similar findings of public interest under both Acts, and the consistency clause requires that "merger of the debtor's property shall not be inconsistent with . . . [the Commerce Act,] their procedural and jurisdictional requirements do not overlap." Callaway v. Benton, 336 U.S. 132, 140 (1949). *Cf. In re* Chicago, R.I. & P. Ry., 168 F.2d 587, 594 (7th Cir.), *cert. denied sub nom.* Texas v. Brown, 335 U.S. 885 (1948) (the controlling provisions of a § 77 merger are set in § 77, and not in § 5 of the Commerce Act); Florida East Coast Ry. Reorganization, 267 I.C.C. 729, 731 (1948).

During the Congressional debates on § 77, Representative La Guardia, primary draftsman of the bill, stated that it was "the intent of the drafters of this section . . . to give the Interstate Commerce Commission broad and complete powers in the initiation, formulation, and approval of *any plan* for the reorganization of a railroad . . . ." 76 CONG. REC. 2927 (1933) (emphasis added). For more remarks of the same tenor, made by those for and against the bill, see *id.* at 2910, 2919, 2928.

Moreover, the consistency clause has appeared in § 77(b), dealing with what a reorganization plan might contain; and in §§ 77(e) and 77(f), dealing with ICC powers to consummate already-approved plans. See St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 307 n.8 (1954). If Congress had intended the consistency clause to limit those who might *propose* merger plans, however, it might be supposed that such a limitation would have been placed in § 77(d), dealing with who may propose plans.

61. Callaway v. Benton, 336 U.S. 132, 140 (1949); *In re* Chicago, R.I. & P. Ry., 168 F.2d 587, 594 (7th Cir.), *cert. denied sub nom.* Texas v. Brown, 335 U.S. 855 (1948); Florida East Coast Ry. Reorganization, 267 I.C.C. 729, 731 (1948). See Letter from Joseph B. Eastman to Senator Hastings, dated Jan. 31, 1933, reproduced in *Hearings before the Special House Subcommittee on the Judiciary on S. 1869*, 76th Cong., 1st Sess. 144, at 155 (1939). *See* also St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298, 324 (1954) (dissenting opinion).

62. See note 61 *supra*.